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		ACTION	INFO	DATE	INITIAL
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8	DDS&T				
9	Chm/NIC				
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11	IG				
12	Compt				
13	D/EEO				
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15	D/OEA				
16	C/PAD/OEA				
17	SA/IA				
18	AO/DCI				
19	C/IPD/OIS				
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Executive Secretary
10/27/82
Date

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THE WHITE HOUSE
WASHINGTON

CABINET AFFAIRS STAFFING MEMORANDUM

DATE: 10/26/82 NUMBER: 077560CA DUE BY: ____________

SUBJECT: Cabinet Council on Economic Affairs - October 28, 1982
8:45 a.m. in the Roosevelt Room

	ACTION	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☑
Attorney General	☐	☑
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☑	☐
Transportation	☑	☐
Energy	☐	☑
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
CEA	☐	☑
CEQ	☐	☐
OSTP	☐	☐
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	ACTION	FYI
Baker	☑	☐
Deaver	☐	☐
Clark	☐	☑
Darman *(For WH Staffing)*	☑	☐
Harper	☑	☐
Jenkins	☐	☑
Wheeler	☐	☑
Kudlow	☐	☑
____________	☐	☐
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____________	☐	☐
____________	☐	☐
____________	☐	☐
CCCT/Gunn	☐	☐
CCEA/Porter	☑	☐
CCFA/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCLP/Uhlmann	☐	☐
CCMA/Bledsoe	☐	☐
CCNRE/Boggs	☐	☐

REMARKS: The Cabinet Council on Economic Affairs will meet Thursday, October 28, 1982 at 8:45 a.m. in the Roosevelt Room. The agenda and papers are enclosed.

DCI EXEC REG

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

☑ Becky Norton Dunlop
Director, Office of
Cabinet Affairs
456-2800

THE WHITE HOUSE

WASHINGTON

October 26, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the October 28 Meeting

The agenda and papers for the October 28 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The Council is scheduled to consider an issue that has been under consideration for some time by the CCEA Working Group on Federal Credit Policy: the budget treatment of Federal Financing Bank activities. A memorandum from Lawrence A. Kudlow, chairman of the Federal Credit Policy Working Group, on the Federal Financing Bank containing a series of recommendations is attached. A memorandum from William Poole, a member of the Council of Economic Advisers, on this issue is also attached.

Attachment

THE WHITE HOUSE

WASHINGTON

THE CABINET COUNCIL ON ECONOMIC AFFAIRS

October 28, 1982

8:45 a.m.

Roosevelt Room

AGENDA

1. Federal Credit Policy: Federal Financing Bank (CM#113)

CM #113

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

October 26, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: LAWRENCE A. KUDLOW LAK

SUBJECT: THE FEDERAL FINANCING BANK

The Working Group on Federal Credit recommends to the Cabinet Council on Economic Affairs that:

- o The Federal Government move toward a consolidated cash budget, which would reflect all the off-budget cash outlays of the Government by including in the budget all Federal Financing Bank (FFB) activities (other off-budget Federal entities, such as the Strategic Petroleum Reserve, the U.S. Railway Association and the Rural Telephone Bank, should also be on-budget).

- o Outlays currently attributed to the Federal Financing Bank be charged to the agencies responsible for generating those outlays.

- o All Federal financing activities, including guaranteed securities, should, over time, be consolidated through the Treasury, i.e., there should be no sales of full faith and credit obligations by any Federal activitiy except the Treasury Department. This consolidation should include all obligations that would ordinarily be financed in investment securities markets.

- o The Administration submit legislation that would make these changes effective beginning Fiscal Year 1984. Senator Proxmire has introduced a bill (S. 2162) that moves in the direction of an inclusive cash budget. The bill has served to interest and educate many in Congress on the question.

The Working Group bases these recommendations on several principles and observations.

- o The Budget should reflect total Federal cash outlays, and the Federal deficit should fully measure the total amount of new Federal borrowing required each year.

- o Off-budget activities, of which the FFB is the predominant source, are not subjected to the same scrutiny, control and spending limitations as on-budget activities. As a result, real off-budget spending grew at over 3 1/2 times the rate of real on-budget spending over the period 1976-81.

- o There is no logic or self-evident accounting or policy principles that can explain the current off-budget treatment of selective spending and lending programs.

- o Federal loan guarantees are no different in substance from direct loans, and they should be financed on-budget.

I. The Overall Credit Problem

The FFB is a major conduit, although not the only vehicle, for Federal banking activities and credit assistance. In recent years the spiralling growth of these banking activities has impeded the expansion of capital formation and economic growth.

In 1983, total Federal borrowing is projected to absorb 73% of net private U.S. savings. Without policy changes, the projected absorption rate is not expected to change materially in the outyears. When Federal loan guarantees are included, the estimate of net private savings absorbed by the Federal Government increases even more.

The estimated 1983 absorption rate is not an aberration, but continues a trend begun in the 1970's. In 1971, the absorption rate for total Federal borrowing was 24.7%, in 1975-77 52.3%, in 1982 73.2%, and in 1984-85 is projected to be 75%.

The potential consequences of this capital absorption are substantial.

- o Fewer capital resources will be available to the private sector. It is difficult to envision rapidly growing private sector investment for 1983 and the outyears when the Federal Government is projected to absorb such a large share of net private savings.

- o The probability of upward interest rate pressures is greater as an avalanche of new Federal debt issues is offered to the market while the private sector competes for a smaller pool of loanable funds.

- o This capital absorption by the Federal government leaves a smaller savings supply for private firms without the benefit of special Federal preferences. As a result, these firms are forced to pay higher financing costs, and in many cases they are crowded out of market participation.

- Moreover, Federally-assisted borrowers are frequently less productive than unsubsidized private borrowers. This preemption of capital that could be more efficiently employed in private hands has caused a misdirection of investment resources and has substantially inhibited economic growth. Also this source of Federal intervention has distorted the market's assessment of true risk and return.

II. The Government As Banker

The growth in Federal credit activity is, in part, the product of a massive, far-flung system of what are essentially direct banking activities. These activities occur in three distinct categories:

- Direct lending by on-budget agencies such as the CCC and Export-Import Bank, which appear in budget outlay and deficit totals.

- Direct lending by both on- and off-budget agencies, such as the Farmers Home Administration (on-budget) or Rural Telephone Bank (off-budget), which is removed from the budget by the sale of loan assets to the FFB or by law.

- FFB direct loan originations to fund guarantees issued by other agencies. The largest programs in the category are Foreign Military Sales-FFB loan, FFB-Rural Electrification Authority utility financing loans and TVA loan guarantees purchases by FFB. All of these outlays appear off-budget due to the FFB transaction.

It is the recommendation of the Working Group that all Federal banking activity be recorded on-budget.

- The purpose of the budget is to convey the amount of resources absorbed by the Government.

- Through the use of the FFB, loan guarantees lead to direct cash disbursements which in an accounting sense are identical to direct loans and other budget outlays.

- This Federal lending is fundamentally different from private commercial lending: it is designed to produce substantial, systematic and persistent investment losses in order to effect social policy or national security objectives.

- Programs whose outlays are not commited in budget totals are given an incentive to escape scrutiny, control and spending limitations. As the record clearly shows, they tend to grow much faster than their on-budget counterparts.

Table 1

COMPOSITION OF DIRECT FEDERAL BANKING ACTIVITY BY BUDGETARY STATUS
(billions, FY 1982)

Program/Activity	New Obligations	Net Outlays	Outstandings
Category #1: On-Budget Direct Loans			
1) Economic Support Fund	0.2	0.7	5.2
2) Foreign military credit sales	0.9	-0.2	0.5
3) PL-480 export loans	0.8	0.5	8.2
4) CCC price support loans	8.6	1.7	7.9
5) Export-Import Bank	4.4	1.7	17.5
6) FDIC	---	-*	0.4
7) National credit union	0.3	0.1	0.2
8) SBA business and investment loans	0.7	0.2	2.9
9) SBA disaster loans	0.6	-0.1	6.3
10) All other on-budget direct loans	11.3	-0.2	56.3
11) Sub-total category #1	27.8	4.4	105.4
12) Percent of direct banking total	49%	21%	51%
Category #2: Direct Agency Loans Recorded Off-Budget			
13) Agricultural Credit Insurance Fund	5.4	1.1	23.4
14) Rural Housing Insurance Fund	5.6	3.2	24.4
15) Rural Development Insurance Fund	1.5	1.0	6.4
16) REA Direct Loan Revolving Fund	0.6	0.6	3.2
17) Rural Telephone Bank	0.2	0.2	1.2
18) All other agency direct loans recorded off-budget	---	*	0.4
19) Sub-total, direct agency loan recorded off-budget	13.4	6.2	59.0
20) Percent of direct banking total	24%	30%	29%
Category #3: FFB Originations of Agency Loan Guarantees Recorded Off-Budget			
21) REA utility loans	4.3	4.3	16.7
22) FMS loans	3.3	2.7	11.8
23) TVA bond purchases	4.3	0.2	1.1
24) Public housing loans	1.3	1.2	2.2
25) All other FFB originations	2.0	1.8	9.6
26) Sub-total, FFB loan originations recorded off-budget	15.2	10.2	41.4
27) Percent of direct banking total	27%	49%	20%
28) GRAND TOTAL, DIRECT FEDERAL BANKING ACTIVITY	56.4	20.8	205.8
29) Percent Recorded On-Budget	49%	21%	51%
30) Percent Recorded Off-Budget	51%	79%	49%

* Not additive.

As Table 1 illustrates, of the 1982 Federal banking activities: 51% of new obligations; 79% of net outlays; and 49% of outstandings are recorded off-budget. This level of off-budget activity is the continuation and result of a decade-long trend. Over the years 1976-81 off-budget spending grew by 22.2%; on-budget spending grew by 11.8%. Nominal GNP grew at an 11.1% rate.

Table 2
Comparative Growth Rates, 1976 - 1981

Nominal Growth (%)

1)	GNP	11.1
2)	Federal On-budget	11.8
3)	FFB	27.6
4)	Off-budget Total	22.2

Real Growth (%)

1)	GNP	2.9
2)	Federal On-budget	3.6
3)	Off-budget Total	13.2

III. DETAILS OF THE FEDERAL FINANCING BANK

The predominant component of off-budget spending is the FFB. Created in 1974 to consolidate the separate public borrowing efforts of Federal agencies, the FFB has become a mechanism for placing Federal credit subsidies off-budget.

Table 3
Growth of FFB and Off-Budget Outlays
FY 1970-1981
($ billions)

	1973	1976	1979	1980	1981
FFB	---	5.9	13.2	14.5	21.0
Total Off-Budget	0.1	7.3	12.5	14.2	21.0

Table 4
Current Services Outlook for Off-Budget Outlays
($ billions)

	1983	1984	1985	1986	1987
FFB	16.7	15.5	15.2	15.9	15.7
Other Off-Budget	5.2	5.5	3.6	2.9	2.0
Total Off-Budget	21.9	21.0	18.8	18.8	17.7

Types of FFB Activities

The FFB carries on three types of transactions -- guaranteed loan originations, purchases of loan assets, and purchases of agency debt (Table 5).

A) Guaranteed Loan Originations

Guaranteed loan originations are made when the FFB makes a loan to a private or non-Federal borrower backed by a Federal agency guarantee. The funds provided in this manner are made available to borrowers at 1/8% above the Treasury's cost of funds. This provides recipients with a substantial Federal subsidy.

Guaranteed loan originations convert a guaranteed loan into a direct loan since Federal funds are provided directly to the borrower. Despite this, no outlays for such programs are reflected in the budget. The resulting FFB outlays are excluded by law from the budget totals and are counted as off-budget outlays. Similarly there is no budget outlay for the guaranteeing agency (except those that relate to default and administrative expenses). In 1980 these originations totaled \$6.8 billion, in 1981, \$9.4 billion, and are estimated to be \$10.2 billion in 1982.

Guaranteed loan originations have become an increasing proportion of FFB activity. In 1975 they accounted for 9% of all FFB acquisitions. By 1981 this proportion had increased to 50%. The majority of guaranteed loan originations by the FFB are the Rural Electrification Administration and foreign military credit sales, which together accounted for 43% of guaranteed loan originations in 1981 and an estimated 50% in 1982.

Table 5

COMPOSITION OF 1981 ACTUAL FFB ACTIVITY
(in billions)

		Outlays	New Acquisitions	Outstandings	Interest Rates
A)	Guaranteed Loan Originations				
1)	Foreign military sales credit	1.9	2.5	9.1	T-bill+
2)	REA guarantees	3.9	4.0	12.3	T-bill+
3)	Low-rent public housing	0.8	0.8	0.9	12.3
4)	Community development guaranteed loans	*	*	0.1	3.0
5)	SBA investment company and other ..	0.1	0.2	0.6	15.0
6)	DOT railroad loans	0.2	1.8	1.5	4.9
7)	NASA satellite lease	0.1	0.1	0.6	T-bill+
8)	Alternate fuels and other energy ..	*	*	*	T-bill+
9)	TVA	0.2	3.6	0.9	3.7
10)	All other	2.1	2.0	5.1	T-bill+
11)	Direct loan, subtotal	9.4	15.1	31.1	
B)	Loan Asset Purchases:				
12)	Agricultural credit fund	$5.8	$6.8	$22.4	9%
13)	Rural housing fund	4.0	6.0	21.1	3.6
14)	Rural development fund	1.0	1.6	5.3	7.8
15)	Farmers home, sub-total	(10.8)	(14.4)	(48.8)	6.8
16)	REA direct loans	0.7	0.7	2.6	4.7
17)	SBA/HHS & OPIC	*	0.1	0.4	6.9/15.0
18)	Loan asset purchases, sub-total ...	11.5	15.2	51.8	N/A
19)	TOTAL, FFB	21.0	30.3	82.9	

* $50 million or less

B) Loan Asset Transactions

Loan asset transactions are largely FFB purchases of certificates of beneficial ownership (CBO's) -- a pool of direct Federal loans made under a direct loan program and guaranteed by the agency when sold to the Bank. The agency actually retains and services the loans. The FFB uses its guaranteed beneficial ownership as collateral for the funds it provides the agency. In return for this asset the FFB provides the agency with additional funds to be used in its lending programs.

Budget principles and the nature of loan asset transactions with the FFB (the assets are not actually sold) would require that the transactions be considered borrowing and budget authority be required.

However, the law requires that such transactions be scored for both FmHA and REA as offsetting collections rather than borrowing. This reduces the outlays of those agencies by the amount of the asset sale and increases the amount of loans that can be made.

Loan asset transactions have been a sizable proportion of FFB acquisitions through 1982. In 1975 they accounted for 40% of all FFB annual acquisitions, in 1980 55%, and in 1982 are estimated to be 46%.

C) Agency Debt Purchases

Agency debt purchases by the FFB occur when agencies borrow from the FFB instead of selling their debt in the market. Since 1977 agency borrowing has been in the range of 15% to 38% of net acquisitions. The largest sellers of agency debt are the Export-Import Bank and TVA, which have accounted for 97% or more of the FFB's acquisition of agency debt since 1977.

Agency borrowing from the FFB is a means of financing agency activities. Outlays are recorded for the agency when the proceeds of the loan are utilized. FFB purchase of agency debt thus does not constitute an evasion of the budget process.

EXECUTIVE OFFICE OF THE PRESIDENT

COUNCIL OF ECONOMIC ADVISERS

WASHINGTON, D.C. 20500

October 26, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: WILLIAM POOLE W.P.

Subject: The Federal Financing Bank

Members of the Working Group on Federal Credit from the Council of Economic Advisers take a position on the FFB that differs in certain respects from the position explained in the memo to the CCEA by Lawrence A. Kudlow (dated October 25, 1982). We agree that there is a compelling case for bringing federal credit activities under tight budgetary control. We do not agree, for the reasons below, that the gross amount of FFB financing should be brought on budget.

(1) Including the FFB in the budget would distort the measurement of the true economic costs of Federal credit programs.

- The true cost to the Federal Government of a direct loan program is the difference between the loans made and the repayments received with due allowance for interest compounding. The cost of a particular loan would be nil if the loan carries the same rate of interest as that on Government debt (no interest subsidy) and the loan is repaid in full (no default). The interest subsidy component of the true cost is measured by the difference between the Treasury's borrowing rate and the rate charged on the direct loan. Following procedures similar to those of private lending institutions, the default rate can be estimated and this component of the true cost entered as a budget item.

- The true cost of a loan guarantee program is measured by the defaults that must be covered by Federal outlays, less any fees earned. At least as a first approximation, guaranteed loans that do not go into default do not cost the Federal Government anything (except for administrative expense). The budget should include an estimate of defaults but not the entire amount of loans guaranteed.

(2) Placing the FFB on-budget might channel Federal resources away from current credit assistance programs and toward programs with equivalent short-run budget outlays but higher real economic costs.

The danger in charging an agency's budget with the full amount of a direct loan rather than with the estimated future defaults and the interest subsidy is that the agency then has an incentive to increase the subsidy rate. Under the proposal that gross credit extensions be placed on-budget, the first year charge against an agency's budget would be the same if a direct loan carried an interest rate of 10 percent, 5 percent, or zero. Thus, the agency and the Congress would have a strong incentive to deepen subsidies -- to convert loans into grants.

These two points do not reflect in any way approval of Federal credit programs. Indeed, explicit accounting for estimated defaults and interest subsidies may be more effective in controlling these programs than entering the gross amounts of credit extensions and guarantees into the budget. It may also be true that Congress will be more willing to include in the budget a true measure of the cost of Federal credit programs than to include the gross amount of new direct loans and new guarantees, both because the budget number will be smaller and because the concept is more nearly in accord with beliefs about what programs really cost.